Performance of Islamic Banking

In Pakistan

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CONTENTS

- Introduction
- Islamic Financing
- Probation of Riba
- Islamic financing Methods
- Growth
- Financing in Islamic banking
- Current issues
- Empirical Results of Islamic Banking
- Conclusion
- Recommendation

Introduction

The Prophet said: "There will come a time for men when no one will be anxious about profits, whether lawful or unlawful" Bukhârî, Ventes (34), bâb 7.

Islamic banking in Pakistan started around three decades ago with an initiative of elimination of interest from the operations of specialized institution and commercial banks in 1977-78, but the serious efforts have been the part of recent past only when in January 2000, State Bank of Pakistan (SBP) constituted a Commission for Transformation of Financial System (CTFS) to introduce Shari'ah compliant modes of financing, and, on 15 September 2003, when the State Bank of Pakistan (SBP) established the Islamic Banking Department. As a result of these staid efforts, Islamic banking is now playing an important role in financing and contributing to different economic and social sectors in the country in compliance with the principles of Islamic Shari'ah in Islamic banking practices

Introduction

To give a real boost to Islamic banking operations in Pakistan, in an historic initiative, in January 2002, Meezan Bank Limited was granted first Islamic Banking License by the State Bank of Pakistan to operate as first full-fledged Islamic bank in Pakistan.

Islamic banks in Pakistan are only six in total and majority of these Islamic banks started their operations only recently except Meezan Bank Limited which is in operation for last more than six years. On the contrary, conventional commercial banks in Pakistan are comparatively quite large in size and number, and majority of these banks is operating in Pakistan for last more than a decade.

Islamic Financing

I would like to preempt two opposing reactions that many people may have once they recognize that "Islamic finance" is in many ways very similar to conventional finance. Some may feel that this similarity is an attempt to dilute the Islamic teachings to simplify our lives, while others may feel that the Islamic Legal distinctions between Islamic and regular finance are artificial means of creating an industry where none is needed To explain my point of view about this issue, let me use a good analogy: the issue of

"Islamic Marriage".

In certain respects, "A Marriage is a Marriage", but in other respects, to abide by all the requirements of the Islamic marriage contract, the Muslim man and woman need to do some extra work

Islamic Financing

Similarly, the notion that “a marriage is a marriage” may be applied in the realm of finance, e.g. “a lease is a lease”. In this domain also, the Muslim needs to ensure that the contract he signs with the lessor or lessee agrees with the conditions of the lease contract (‘aqd al-’ijarah or ‘aqd al-’ ıjar) in Islamic jurisprudence. Those conditions are put in place to ensure that the contract would not contain elements of Riba or Gharar, which are forbidden in Islam. In this sense, “Islamic banks” or “Islamic financial institutions” try to ensure that all their contracts adhere to Islamic legal requirements as well as state requirements.

Allah (swt) did not deny that apparent similarity, but decisively informed that “but Allah has permitted trade and forbidden riba” [2:275]. The legal differences between the two are clear,

Probation Of Riba

One of the most popular translations of the meaning of the Quran, Yusuf ‘Ali (1991), translates the meaning of verses [2:278-279] thus:

“278. O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are Indeed believers. 279. If ye do not, take notice of war from Allah and His Messenger: but if ye turn back, ye shall have your capital sums; Deal not unjustly, and ye shall not be dealt with unjustly. “

Hadith Against Riba

"Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt; like for like, hand to hand, in equal amounts; and any increase is Riba."

The Messenger of Allah (pbuh) cursed the one who devours Riba, the one who pays it, the one who witnesses it, and the one who documents it.

Islamic Financing Methods

Most types of trade (buying and selling) are permitted in Islam, where prohibition is the notable exception. Yusuf ‘Ali (1991) translated the meaning of [2:275] thus:

Those who devour usury (riba) will not stand except as stands one whom the Evil One by his touch hath driven to madness. That is because they say: ‘trade is like usury’, but Allah hath permitted trade and forbidden usury

Islamic Financing Methods

A valid trade is concluded in Islam if the seller and buyer exchange an offer and acceptance which specify the object of sale and the price, and they both agree.

The Prophet (pbuh) was asked: “which are the best forms of Income generation?” He (pbuh) replied: “A man’s labor, and every legitimate sale”.

Islamic Financing Methods

- *We used contracts in Islamic finance, utilizing both their Arabic and English names.*

- *Cost-plus sales (murabaha)*
- *Credit Sales (bay‘ bithaman ’ajil)*
- *Leasing (ijarah or “ıjar)*
- *Partnership (musharaka and mudaraba)*
- *Islamic forwards (salam and istis.na)*

Growth

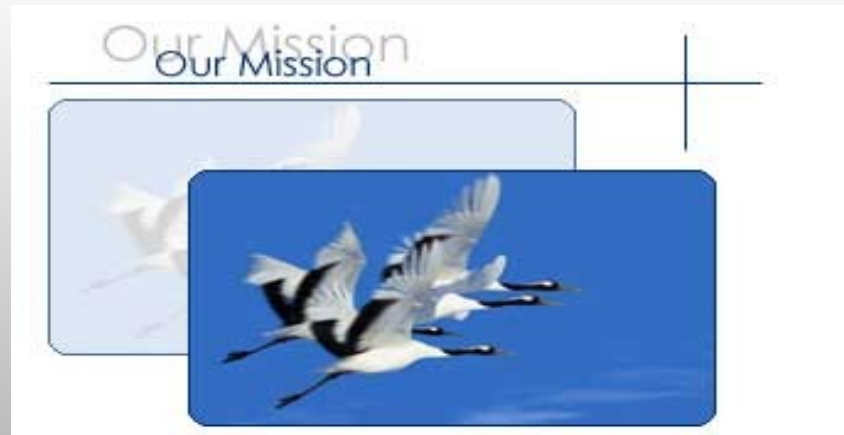
Islamic Banking Department was established on 15th September, 2003 and has been entrusted with the task of promoting & developing the Shariah Compliant Islamic Banking as a parallel and compatible banking system in the country. Islamic Banking is one of the emerging field in global financial market, having tremendous potential and growing at a very fast pace all around the world.

In January 2002, Meezan Bank Limited was granted first Islamic Banking License by State Bank of Pakistan.

Al-Hamdulillah, the progress of Islamic Banking in Pakistan has also been commendable during the last Five years. Currently there are six licensed full fledged Islamic Banks and twelve conventional banks with standalone Islamic Banking Branches

To make Islamic banking the banking of first choice for the providers and users of financial services (SBP)

To be the leading provider of innovative financial services in accordance with the legislation of Allah (DIB)

To become a leader among Islamic Banks of the country in the coming years capturing major share of the domestic Islamic financial market.. (MCB)

We are proud to be the first Islamic Bank worldwide that has translated true Islamic economic principals into practice, out of firm belief in the need of mankind for an economic system based on the final Revelation. By partnering with our customers in halal earnings, employing best business practices, the latest financial services technologies and placing our trust in Allah, we are confidant of our success. (DIB)

To promote and develop Islamic Banking industry in line with best international practices, ensuring Shariah Compliance and transparency. (SBP)

Where we are Today

- 6 full fledged Islamic banks
- 12 conventional banks with Islamic banking branches
- Over 500 total licensed Islamic banking branches in 64 cities & town
- In assets (7%); PKR 251 billion and in deposits PKR 171 billion (4.2%) of industry – as of September , 2008
- 3 licensed Takaful companies

Islamic Banking Branch Network

As of December 31. 2008

Type	Name of Bank	Branches
Full Fledge Islamic Banks	AlBaraka Islamic Bank	30
	BankIslami Pakistan Limited	70
	Dawood Islamic Bank Limited	15
	Dubai Islamic Bank Pakistan Ltd	23
	Emirates Global Islamic Bank Ltd	40
	Meezan Bank Ltd	131
	Sub Total	**309**
Islamic Branches of Conventional Banks	Askari Bank Limited	18
	Bank Alfalah Ltd	48
	Bank Al Habib	4
	Habib Bank Ltd	1
	Habib Metropolitan Bank	4
	MCB Bank Ltd	11
	National Bank of Pakistan	4
	Soneri Bank Ltd	6
	Standard Chartered Bank	8
	The Bank of Khyber	16
	The Royal Bank of Scotland	3
	United Bank Ltd	5
	Sub Total	**128**
Sub Branches	Askari Bank Limited	2
	BankIslami Pakistan Limited	32
	Dawood Islamic Bank Limited	6
	Dubai Islamic Bank Pakistan Ltd	2
	Meezan Bank Ltd	35
	Sub Total	**77**
	Grand Total	**514**

Industry Progress & Market Share

- ***The share of Islamic banking institutions' assets, deposits, and financing & investment increased to 4.6%, 4.2% and 4.4% respectively at the end of quarter.***

(Rs. in billion)

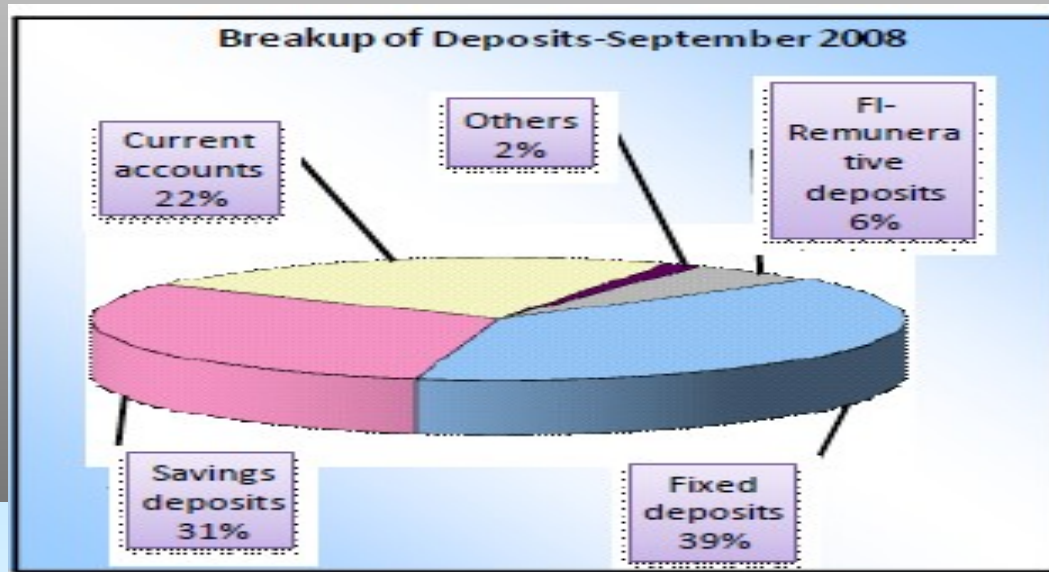
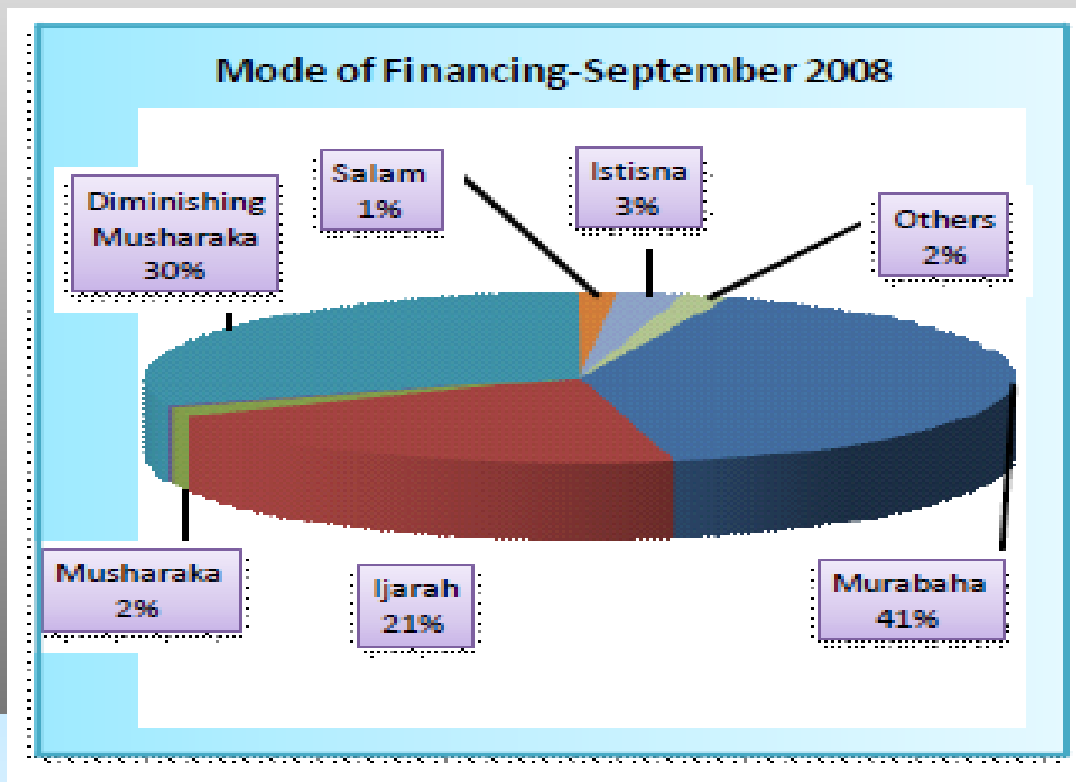
Descriptions	Sept-08	Dec-07	Dec-06	Dec-05	Dec-04	Dec-03
Total Assets	251	206	119	72	44	13
% of Banking Industry	4.6%	4.0%	2.8%	2.0%	1.5%	0.5%
Deposits	171	147	84	50	30	8
% of Banking Industry	4.2%	3.8%	2.6%	1.8%	1.3%	0.4%
Financing. & Investment	182	138	73	48	30	10
% of Banking Industry	4.4%	3.5%	2.3%	1.7%	1.3%	0.5%
No. of Full Fledge Islamic Banks	6	6	4	2	2	1
No. of Conventional Banks with Islamic Banking Divisions	12	12	12	9	9	3
No. of Branches	367	289	150	70	48	17

Financing in Islamic Banking

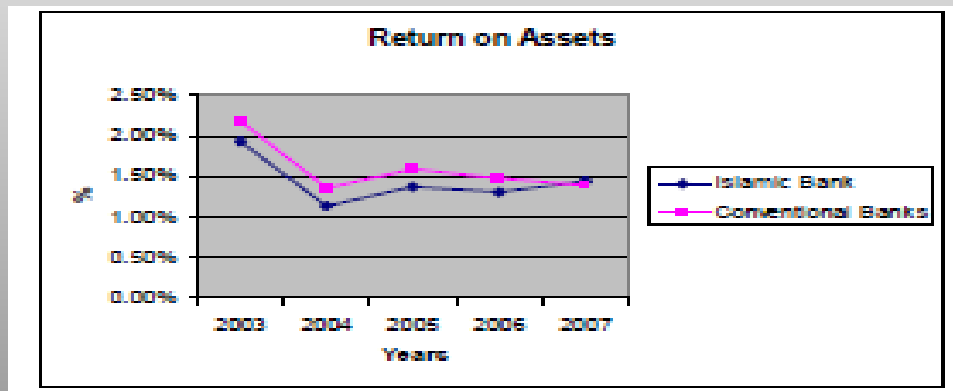
- Deposits

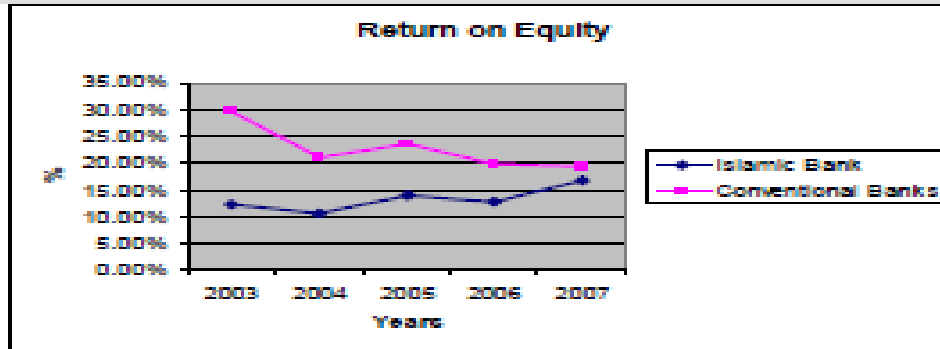
Biztek

Financing

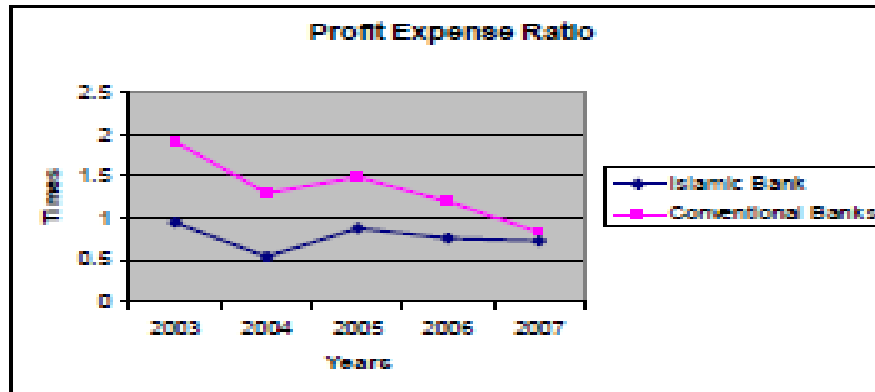
Mode of Financing-September 2008
Diminishing Musharaka 30%
Salam 1%
Istisna 3%
Others 2%
Musharaka 2%
Ijarah 21%
Murabaha 41%

Current Issues

- ***Standardization***
- ***Standardization is urgently needed in the following respects:***
- ***vocabulary of Islamic financing.***
- ***financial instruments and their documentation.***
- ***pricing formulas for Islamic financial products.***
- ***Public Awareness***
- ***Training of Banking Professionals in the Use of Islamic Financial Products***
- ***Establishment of Real Market Links***
- ***Accounting***
- ***Migration from Riba-Based to Riba-Free Banking***
- ***Further Shari'ah Research***

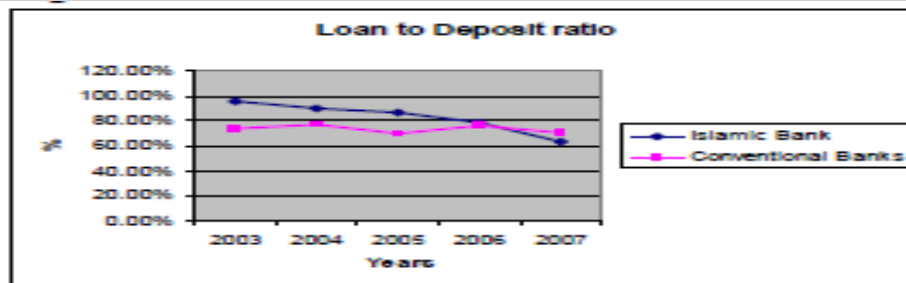
Profitability Ratio
Return On Assets

	2003	2004	2005	2006	2007	*Mean*	*S.D*
Islamic Bank	1.93%	1.14%	1.37%	1.30%	1.43%	*1.49%*	*0.00296*
Conventional Banks	2.18%	1.35%	1.59%	1.47%	1.38%	*1.59%*	*0.0034*

Return On Equity

	2003	2004	2005	2006	2007	*Mean*	*S.D*
Islamic Bank	12.23%	10.69%	13.87%	12.69%	16.88%	*13.27%*	*0.02317*
Conventional Banks	29.83%	21.04%	23.60%	19.95%	19.38%	*22.76%*	*0.04271*

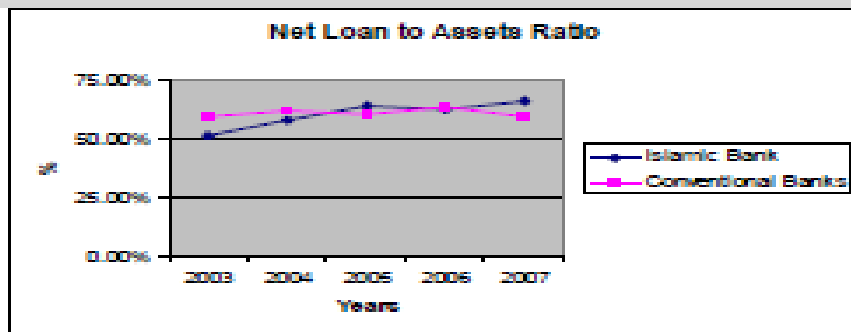
Source: IB, SBP

Profit Expense Ratio (PER)

	2003	2004	2005	2006	2007	*Mean*	*S.D*
Islamic Bank	0.94	0.54	0.88	0.76	0.72	*0.77*	*0.155306*
Conventional Banks	1.91	1.3	1.48	1.2	0.82	*1.34*	*0.398773*

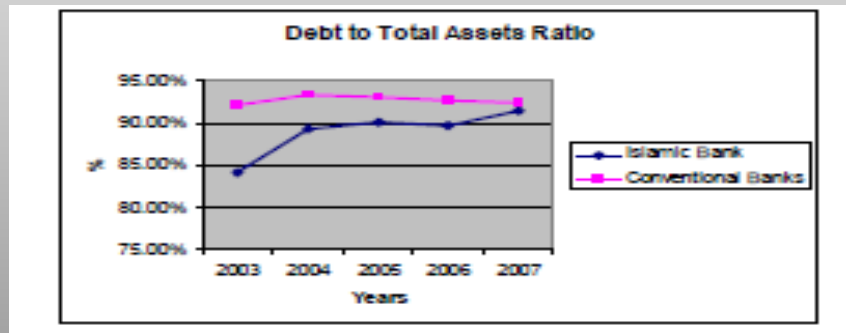
Source: *IB,SBP*

Liquidity Ratio
Loan to Deposit Ratio (LDR)

	2003	2004	2005	2006	2007	*Mean*	*S.D*
Islamic Bank	95.36%	89.61%	86.70%	78.47%	63.35%	*82.70%*	*0.12413*
Conventional Banks	73.85%	76.66%	69.90%	76.44%	70.89%	*73.55%*	*0.03103*

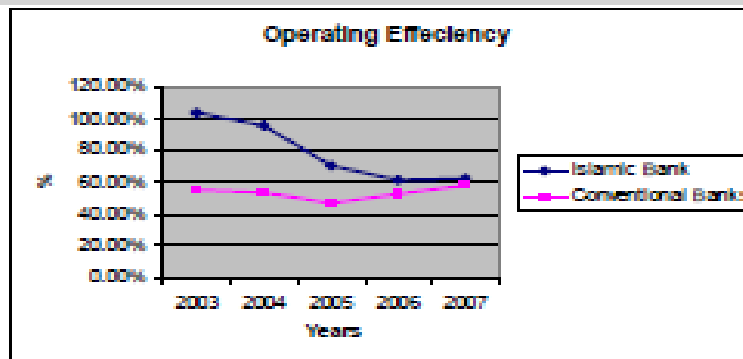
Source: *IB,SBP*

Loan to Asset Ratio (LAR)

	2003	2004	2005	2006	2007	*Mean*	*S.D*
Islamic Bank	51.47%	58.21%	64.35%	62.65%	66.63%	*60.66%*	*0.05993*
Conventional Banks	59.57%	62.44%	60.63%	63.99%	59.78%	*61.28%*	*0.01890*

Source: *IB,SBP*

Debt to Total Assets Ratio (DTAR)

	2003	2004	2005	2006	2007	*Mean*	*S.D*
Islamic Bank	84.25%	89.35%	90.14%	89.74%	91.51%	*89.00%*	*0.02776*
Conventional Banks	92.22%	93.39%	93.12%	92.67%	92.48%	*92.78%*	*0.00475*

Source: *IB,SBP*

Operating Efficiency (OE)

	2003	2004	2005	2006	2007	*Mean*	*S.D*
Islamic Bank	103.39%	95.94%	70.37%	61.99%	62.23%	*78.78%*	*0.19536*
Conventional Banks	54.95%	53.51%	47.43%	52.95%	58.72%	*53.51%*	*0.04076*

Conclusion

The performance measurements of Islamic banking in Pakistan are different and at times mixed in comparison to the results drawn from the similar studies done in different parts of the world. For example, Kader and Asarpota (2007) found in their study that UAE Islamic banks are relatively more profitable, less liquid, less risky, and more efficient as compared to the UAE conventional banks. Samad & Hassan (2000) revealed in their study that BIMB (Bank Islam Malaysia Berhad) is less profitable, relatively less risky and more solvent as compared to conventional banks of Malaysia.

The difference in results is largely due to the fact that Islamic banking has longer history in these countries as compared to Pakistan where full-fledged Islamic banking started merely few years back. Moreover, conventional banking has a longer history, deeper roots, vast experience of learning from the financial markets mechanisms, and larger share in the Pakistan financial sector. Considering these facts of the matter, we don’t find the results of our study surprising. However, the way Islamic banking sector is improving and growing in Pakistan.

Recommendation

- ***Without interest there will be no investment .***
- ***Permission of trade but prohibition of riba .***
- ***Name of "Islam" is being used.***
- ***Lack of Trained Staff.***
- ***Lack of Advertisement.***
- ***More Efficient Work on Musharka.***
- ***Islamic Bench Mark .***